City of Detroit

CITY COUNCIL

IRVIN CORLEY, JR.
DIRECTOR
(313) 224-1076

FISCAL ANALYSIS DIVISION
Coleman A. Young Municipal Center
2 Woodward Avenue, Suite 218
Detroit, Michigan 48226
FAX: (313) 224-2783
E-Mail: irvin@cncl.ci.detroit.mi.us

ANNE MARIE LANGAN
DEPUTY DIRECTOR
(313) 224-1078

TO: COUNCILMEMBERS

FROM: Irvin Corley, Jr., Director ICJ

DATE: February 16, 2009

RE: City Council Fiscal Analysis Division Report on the September 30, 2008 Quarterly Financial Report from the Budget Department and Mid Year Budget Analysis

Introduction

On January 9, 2009, the Budget, Finance & Audit Standing Committee received the Budget Department Quarterly Financial Report for the period ending September 30, 2008. This report is required by court order. Attachment I is a copy of the report from the Budget Department.

The Quarterly Financial Report from the Budget Department is limited in scope as defined by the court order to five, actually currently four, major revenue sources and seven departments. One of the major revenues, State Equity Grants, is no longer included in the report as the grants have either been eliminated or go directly to agencies no longer a part of the general fund. The four remaining revenue sources represent 54.4% of the 2008-09 adopted general fund budget for revenues, and the seven departments represent 53.2% of the appropriations in the adopted budget.

The Fiscal Analysis Division's analysis of the quarterly report updates the data through December 31, 2008, and includes the Casino Gaming Fee as an additional major revenue. This increases the percentage of revenues reported to 66.6% of the adopted budget. The report also includes an update of the accumulated deficit as reported in the financial reporting system of the City. Attachment II is the enhanced quarterly report data through December 31, 2008.

Budget Department's Quarterly Financial Report for September 30, 2008

In the cover letter of the report from the budget director it is indicated that the "shortfall could reach $200 million." The basis of the projected shortfall includes the current economic climate, reduced revenue collections, an increased 2007 deficit, and the absence of the sale of fiscal stabilization bonds or a tunnel transaction taking place prior to the end of the fiscal year.

On the bottom of the "Part II General Fund Appropriations" section of the report from the Budget Department a note is made that fringe benefits for the entire general fund are estimated to result in neither a surplus nor deficit by the end of the fiscal year. The monitoring and estimate of a surplus or deficit in fringe benefit accounts is an important area for two reasons. First, the amount of fringe benefit costs incurred by the general fund. The 2008-09 Budget includes $245.8 million for fringe benefits in the general fund, or 16.5% of the adopted budget. Second, due to the method of estimating, charging and year end reconciliation involved with fringe benefit accounts, it is impossible for the Fiscal Division to acquire accurate expenditure to budget data for this category during the year. Therefore an estimate on a quarterly basis from the administration would be a valuable addition for use in our projections.

Overall the Fiscal Analysis Division would concur that it is very possible that a $200 million accumulated deficit will be reported by the city for the year ending June 30, 2009. In fact, this estimate may be on the low side as the administration has indicated a year ending accumulated deficit as high as $300 million being a possibility. While a more precise estimate may be desirable, an accumulated deficit of even the lower amount of $200 million is nearly impossible to address in one fiscal period.

The more significant aspect of an accumulated deficit of even $200 million as of June 30, 2009 is the fact that the accumulated deficit continues to increase. This indicates that the structural budget problems within the city have not been addressed. Addressing the structural budget problem, or "balancing the budget" is the first step necessary to improve the financial status of the city. This must be done as a part of, or prior to addressing the accumulated deficit that has been building over the last several years.

Accumulated Deficit

Table I – Accumulated Deficit
(in millions)

Line No.		Appropriations	Revenues	Net	Accumulated Deficit Estimate as of Dec. 31, 2008	Previously Estimated Accumulated Deficit	Change
1.	Accumulated Deficit as of June 30, 2006 (audited)				$(173.7)	$(173.7)	- 0 -
2.	Prior Year's Deficit Appropriation included in 2006-07 Budget (Amended)	$67.0		$67.0	$(106.7)	$(106.7)	- 0 -
3.	2006-07 Fiscal Year Results (un-audited) – General Fund	$(37.0)	$(16.6)	$(53.0)	$(160.3)	$(142.7)	$17.6 increase in deficit

4.	Accumulated Deficit as of June 30, 2007 (un-audited)				$(160.3)		
5.	Prior Year's Deficit Appropriation included in 2007-08 Budget	$88.6			$(71.7)	$(54.1)	
6.	2007-08 Fiscal Year Results (un-audited) – General Fund	$109.6	$(208.4)	$(98.8)	$(170.5)	$(132.3)	$38.2 increase in deficit
7.	Deficit Appropriation included in 2008-09 Budget	$78.0			$(92.5)	N/A	
8.	Projected 2008-09 Results	$75.0	$(208.2)	$(133.2)	$(225.7)		$26.2 increase in deficit projected

Items for Consideration

Status of Closing Process and Entries in Financial System

Fiscal 2006-07

For fiscal year 2006-07 most closing entries and adjustments are believed to be entered into the financial reporting system. In Table I, on line number 3, the calculated accumulated deficit for June 30, 2007 is $160.3 million. This is within $3 million of the amount recently reported by the Chief Financial Officer as the accumulated deficit of $157.5 million that will be reported in the final Comprehensive Annual Financial Report expected to be release at the end of February 2009.

Fiscal 2007-08

From our analysis it would appear that many closing and adjustment entries for the next fiscal period, fiscal year 2007-08 remain to be entered into the system. Our assumption is the majority of entries for the closing of this fiscal period have not been made, as the administration's efforts have been concentrated on completion of the audit for 2006-07. Some areas in the past that have resulted in significant movement in the final surplus/deficit number include, pension and fringe benefit charge adjustments, analysis of the risk management fund, subsidy requirements for "enterprise funds" like the Department of Transportation, Airport and Parking. Beginning with the 2007-08 fiscal period, we expect that shortages in the special purpose fund, the Solid Waste Fund, will be made up by the General Fund.

It should be noted that the final deficit for fiscal 2005-06 increased by $12 or $13 million dollars near the end of the audit for that year. The reason offered by the administration at the time was the adjustments necessary to correctly reflect various grants on the financial reports for the city. And as the table above shows, the 2006-07 final deficit has increased $17.6 million from the numbers reflected in the financial reporting system as late as October of 2008.

Fiscal 2008-09

Completing an estimate for the current year operations with a high level of confidence is complicated by the fact that previous fiscal periods have not been closed and audited. In general a major portion of our analysis relies on accurate reporting of prior year operations. Until these periods are closed the amount of collections and expenditures remain open to change that also would result in changes to our projections. In addition, the accumulated deficit remains somewhat of a moving target until the prior period(s) are closed. During our analysis of the current period, and in fact the 2007-08 period, it appears that recording of transactions may not be as consistent as we may have observed in the past. We would attribute this to the limited staff resources available to both complete past audits and maintain and review current operations, and the change in overall and financial management and the effort to gain a good handle on the financial status of the city in total. This should not be considered or taken as a criticism, as overall we believe a major effort is being made to improve the financial reporting of the city and provide financial statements in a timely manner. The purpose of the comment is to provide a good basis for understanding the projections and the confidence level that should be applied to them, and how they may defer from the past.

2008-09 Appropriations

Using the raw numbers in the financial reporting system for the current year, as of December 31, 2008 and projecting out for the full year, with adjustments and assumptions, there is a potential for an appropriation surplus in the area of $125 to $150 million for fiscal 2008-09. The assumptions relating to this estimate include: the actual recorded expenditures represent 50% of the total that is expected for the full year, the amount of encumbrances reflected as of December 31, 2008 will be expended by year end, an adjustment for the prior year deficit appropriation, and adjustments for major expenses that have not been recorded as of December.

An indication of how volatile this number is, just changing the assumed percentage for expenditures to 45% from 50%, the year end result would be only a $22.7 million appropriation surplus. Due to the cash flow situation the city faces, and the fact that vendor payments and other expenditures may be "managed" by the administration, this 45% assumption may be more accurate.

Our best estimate is that the appropriation surplus will fall between these two figures. For presentation purposes in the above chart on the accumulated deficit we are using $75 million as our best guess estimate at this time.

The holding of personnel requisitions and maintaining of vacant positions throughout the city along with the associated savings in benefit accounts may explain a portion of the projected appropriation surplus.

Implementation of a budget deficit reduction plan that includes significant savings in the current year would affect this estimate in a positive direction. But the more time that passes before implementation of any plan, the lower the savings will be during the current year.

2008-09 Revenues

2008-09 Revenue Projection Summary (in millions)		Projected June 30, 2009 Results as of Dec. 31, 2008
Municipal Income Tax		$(40.0)
State Revenue Sharing		(4.2)
Property Taxes		- 0 -
Casino Wagering Taxes		(10.8)
Utility Users' Tax		(1.2)
Sale of Property		- 0 -
All Other Revenues including Fiscal Stabilization Bonds		(152.0)
Revenue Total		$(208.2)

Our analysis and projections of revenue accounts relies on past collection historical patterns along with comparison of year to date collections to year end results. Again, not having previous fiscal periods closed and the potential that year end adjustments and accrual entries remain to be recorded reduces the confidence factor for our estimates. For this analysis or revenues we believe it is important to keep in mind the overall economic conditions at the local, state and national levels. Revenue collections and projections that show decreases must be taken seriously and significant justification would need to be presented to even consider adjusting the estimates in a positive manner. The reality is that as citizens are facing employment reductions, business are reducing operations due to decreased demand, and other factors, revenue collections by the city are going to decrease.

Municipal Income Tax – Income tax collections recorded in the financial reporting system through December 31, 2008 are $100.5 million compared to a budget of $275 million. Over a five year period the December 31st collections of income tax represents around 43% of the year end total collection. Based on this assumption, net income tax collections could be as low as $236 million for the year, or as much as a $40 million deficit. The September 30th report from the Budget Department indicated a year end deficit of $20 million in income tax. However, that report showed year to date collections in September already $26.9 million worse than budget. The $100.5 million collections after six months of the fiscal year, is $12 million lower than any of the past six years.

Property Tax – Property tax collections through December 31, are $99.0 million compared to a budget of $177.5 million. Since property taxes can be paid in total in August, or half in August and half in January, collections after August and prior to the end of January, should represent some percentage above 50%. In fact, the half year collections represent a little more than 55% of the total budget. In addition, property taxes that are delinquent, unpaid in March of the fiscal year, are turned over to Wayne County for collection. The County of Wayne sells bonds and reimburses the city for these delinquent property taxes. Therefore, unless an adjustment for administrative costs of the program or for past taxes that are actually uncollectable by the County is required, property taxes collections can be expected to match the budget.

Wagering Tax – Per the regular monthly report of the gaming revenue at the end of December a $10.8 million deficit is projected in this revenue.

Utility User Tax – Collections of the utility user tax through December is $16.3 million. Using the year to date collections to the year end total over the last five years an estimate of $58.7 million in collection is projected, or a deficit of $1.2 million. The Budget Department report indicates a $5.0 million potential deficit in this revenue.

State Revenue Sharing – The collection of state revenue sharing by the city is dependant on two factors, the collection of sales tax by the state and reductions in revenue sharing by legislative action or executive order by the governor. At this point in time the state has not made any reductions in revenue sharing to local governments to address the State's fiscal problems, however that remains a possibility. We are in agreement with the Budget Department projection of a $4.2 million deficit in revenue sharing collections.

All Other Revenues – The analysis of the collection of all other revenues remains an area that is very difficult to analyze as it represents a great number of individual revenue accounts that must be grouped together. Mid year analysis usually results in projections of large deficits in these combined revenue accounts. At this point we have judiciously adjusted the raw projection of these accounts to a $74 million deficit. In addition the sale of fiscal stabilization bonds/tunnel deal or alternative at $78 million combines to a total estimated $152 million deficit.

Conclusion

The most significant conclusion that can be taken from our analysis is that the city has not reached the point of balancing current revenues with current expenditures, the first step in improving the city's financial status. A first step that I am certain the rating agencies are waiting to see before any consideration would be given to an upgrade in the city's bond rating. Even then, the next step, a workable plan to address the accumulated deficit, be it $200 million, $225 million, or even greater, will likely be expected by the bond rating agencies.

Even if it were possible to market fiscal stabilization bonds, the enabling legislation that allows the sale limits the amount to be sold to $125 million. Based on the above analysis, the June 30, 2009 accumulated deficit could approach twice this amount. This means that this possible solution, one that would allow spreading the solution over a period of up to five years, can only address a portion of the problem without changes to the enabling legislation.

Looking forward to the preparation of next year's budget it going to take a concerted effort to identify and fund only those critical services that the citizens cannot do without. While eliminating, transferring, or finding alternate funding sources for, those services that cannot continue to be provided or funded from general tax or revenue sources.

On the positive side, there appears to be a more realistic acceptance by the administration of identification of the problem, rather than the cover up approach of rolling the deficit. Actually the preliminary step necessary before a problem can be address, that is, the honest recognition of the problem has been taken. In addition, there are efforts and advancements being made to improve the financial reporting of the city. However, this will not soften the difficult and hard decisions that will be necessary to address the accumulated deficit.

What can aid in the tough decision making is a cooperative effort, and working together attitude of those involved, the administration, legislative body, employees and bargaining units, and the understanding of the citizens. The ability of the city to spend beyond the amount collected in revenues must come to an end.

One final caution, while our best efforts have gone into this analysis the resulting projected deficit of $225 million as of June 30, 2009, the end of the current fiscal year, cannot be taken out of context, but must be viewed in light of the assumptions made in preparing the projection. Many assumptions and variable must go along with this projection, including the fact that two fiscal periods must be closed along with the requisite analysis and adjustments for such items as fringe benefit accounts, analysis and funding of the risk management fund per the ordinance, subsidy requirements of "enterprise funds". All of these can change the final results as compared to the current projection.

We look forward to and encourage questions and input from all Council Members and the administration, as we firmly believe open discussion and questions can only improve our ability to make projections in the future.

Attachments (2)
cc: Council Divisions
Loren Monroe, Auditor General
Joseph Harris, Chief Finance Officer
Pamela Scales, Budget Director
Arese Robinson, Mayor's Office

Attachment I

CITY OF DETROIT
BUDGET DEPARTMENT
ADMINISTRATION

COLEMAN A. YOUNG MUNICIPAL CENTER
2 WOODWARD AVENUE, SUITE 1100
DETROIT, MICHIGAN 48226
PHONE: 313•224•6260 TTY:311
FAX: 313•224•2827
WWW.DETROITMI.GOV

December 4, 2008

Honorable City Council:

RE: Quarterly Financial Report

Attached please find the quarterly financial report for the period ending September 30, 2008.

At this point we are projecting a shortfall that could reach $200 million, depending on the continued economic climate. The reason for the increase is essential reduced revenue collections, increased 2007 deficit and fiscal stabilization bonds or tunnel transaction not occurring. We are working diligently on a deficit reduction plan that will be submitted to you shortly.

I will be able to discuss this report, if necessary, at your convenience.

Respectfully submitted,

Pamela Scales
Budget Director

cc. Arese Robinson, Mayor's Office
Joseph Harris, CFO

PART I

GENERAL FUND

MAJOR SOURCES OF REVENUE AND ESTIMATED SURPLUS/(DEFICIT)

As of September 30, 2008

	Total Annual Budget	Amount Collected through 09/30/08	Better/(Worse) than Budget Year to Date	% Variance Better/(Worse) than Budget Year to Date	Remaining Annual Budget	% Collected to Date		Estimated Year End Surplus/(Deficit) Manually Computed
						Current Year	Prior Year	
Municipal Income Tax	$ 275,000,000	$ 41,899,606	$ (26,850,394)	-39.06%	$ 233,100,394	15.24%	19.39%	$ (20,000,000)
Current Year Property Tax	177,469,000	83,164,368	38,797,118	87.45%	94,304,632	46.86%	48.21% *	-
Utility Users' Tax	60,000,000	6,314,356	(8,685,644)	-57.90%	53,685,644	10.52%	3.20%	0 - (5,000,000)
State Revenue Sharing								
Sales Tax - Constitutional	$ 63,596,394	$ -	$ (15,899,099)	-100.00%	$ 63,596,394	0.00%	0.00%	$ 802,865
Sales Tax - Statutory	215,863,329	-	(53,965,832)	-100.00%	215,863,329	0.00%	0.00%	(4,955,858)
Subtotal	$ 279,459,723	$ -	$ (69,864,931)	-100.00%	$ 279,459,723	0.00%	0.00%	$ (4,152,993)
Total	$ 791,928,723	$ 131,378,330	$ (66,603,850)	-33.64%	$ 660,550,393	16.59%	17.75%	$ (24,152,993)

Note: State Equity revenues were eliminated from the General Fund upon the transfer of the Zoo and Historical operations to an independent agency in FY 2006.

Note: State Sales Tax- Statutory has a negative actual of ($22,968,388), possibly an accrual reversal.

PART II

GENERAL FUND APPROPRIATIONS

(including fringe benefits)

ESTIMATED SURPLUS/(DEFICIT)

as of September 30, 2008

	Total Annual Budget	Amount Expended through September 30, 2008	Better/(Worse) than Budget Year to Date	% Variance Better/(Worse) than Budget Year to Date	Remaining Annual Budget	% Expended to Date Current Year	% Expended to Date Prior Year	Estimated Year End Surplus/(Deficit) Manually Computed
DEPT OF PUBLIC WORKS	$ 11,935,713	$ 1,229,000	$ 1,754,928	58.81%	$ 11,087,812	10.30%	51.95% **	($200,000) - $600,000
FINANCE	41,111,960	9,010,333	1,267,657	12.33%	38,634,051	21.92%	22.89%	0 - 2,000,000
FIRE	187,195,995	47,671,587	(872,588)	-1.86%	140,493,267	25.47%	25.37%	(300,000) - 300,000
HEALTH	29,237,054	4,883,468	2,425,795	33.19%	26,147,544	16.70%	15.59%	1,000,000 - 2,000,000
POLICE	424,908,402	92,758,539	13,468,561	12.68%	336,958,364	21.83%	20.83%	0 - (2,400,000)
PUBLIC LIGHTING	64,827,195	17,009,619	(802,820)	-4.95%	61,556,953	26.24%	20.66%	(2,000,000) - (5,000,000)
RECREATION	28,751,182	5,258,690	1,929,106	26.84%	25,659,380	18.29%	12.35%	0 - 700,000
TOTAL	$ 787,967,501	$ 177,821,236	$ 19,170,639	9.73%	$ 640,537,371	22.57%	22.08% *	($1,500,000) - ($1,800,000)

NOTE: Fringe Benefits (entire General Fund, excluding pensions) are estimated to surplus/deficit in the amount of ($0).

* Prior year totals erroneously include encumbrances amounts.

** Beginning with fiscal year 2007- 08, the Department of Public Works refuse collection activity is recorded in a separate fund, Fund 3104- Solid Waste

PART I
GENERAL FUND
MAJOR SOURCES OF REVENUES AND ESTIMATED SUPRLUS/DEFICIT
for Dec. 31, 2008, as of Jan. 2009
Prepared by the City Council Fiscal Analysis Division

Column	B	C	D	E	F	G	H	I	J	
Calculation			C x %		E - D	F / D	C - E	E / C		
	Total Adopted Annual Budget	Total Amended Budget	Budget for Report Period 50.0%	Collected through Dec 31, 2008	Better/(Worse) than Budget Year to Date	% Variance Better/(Worse) than Budget Year to Date	Remaining Annual Budget	% Collected to Date Current Year	% Collected to Date Prior Year	Projected Year-End Results
Municipal Income Tax	$275,000,000	$275,000,000	$137,500,000	$103,268,731	($34,231,269)	-24.90%	171,731,269	37.55%	46.92%	($40,000,000)
Current Year Property Tax	177,469,000	177,469,000	88,734,500	87,915,029	(819,471)	-0.92%	89,553,971	49.54%	54.61%	0
Utility Users' Tax	60,000,000	60,000,000	30,000,000	16,347,984	(13,652,016)	-45.51%	43,652,016	27.25%	25.94%	(1,200,000)
State Equity Package										
Historical	$0	$0	$0	$0	$0	#DIV/0!	$0	#DIV/0!	0.00%	0
Zoological	0	0	0	0	0	#DIV/0!	0	#DIV/0!	0.00%	0
Total	$0	$0	$0	$0	$0	#DIV/0!	$0	#DIV/0!	0.00%	0
State Revenue Sharing										
Sales Tax - Constitutional	$63,596,394	$63,596,394	$31,798,197	$11,733,296	($20,064,901)	-63.10%	51,863,098	18.45%	18.26%	800,000
Sales Tax - Statutory	215,863,329	215,863,329	107,931,665	21,771,636	($86,160,028)	-79.83%	194,091,693	10.09%	16.54%	(4,955,000)
Total	$279,459,723	$279,459,723	$139,729,862	$33,504,932	($106,224,929)	-76.02%	$245,954,791	11.99%	16.95%	(4,155,000)
Grand Total	$791,928,723	$791,928,723	$395,964,362	$241,036,676	($154,927,685)	-39.13%	$550,892,047	30.44%	16.95%	(45,355,000)
Casino Gaming Fee	$194,780,000	$194,780,000	97,390,000	$90,779,407	($6,610,593)	-6.79%	$104,000,593	46.61%	45.69%	($10,800,000)

PART II
GENERAL FUND APPROPRIATIONS
(including fringe benefits)
ESTIMATED SURPLUS/(DEFICIT)
for Dec. 31, 2008, as of Jan. 2009
Prepared by the City Council Fiscal Analysis Division

Column	B	C	D	E	F	G	H	I	J	K
Calculation			C x %		D - E	F / D		C-E-H	E/C	
	Total Adopted Annual Budget	Total Amended Budget	Budget for Report Period 50.0%	Amount Expended through Dec 31, 2008	Better/(Worse) than Budget Year to Date	% Variance Better/(Worse) than Budget Year to Date	Encumbrances at Dec 31, 2008	Remaining Annual Budget	% Expended to Date Current	% Expended to Date Prior Year
DEPARTMENT OF PUBLIC WORKS	$11,935,713	$14,928,258	$7,464,129	$4,537,641	$2,926,488	39.21%	$3,353,288	$7,037,329	30.40%	65.65%
FINANCE	41,111,960	46,803,083	23,401,541	19,489,158	$3,912,383	16.72%	2,258,137	25,055,788	41.64%	40.28%
FIRE	187,195,995	187,232,497	93,616,249	101,276,242	($7,659,993)	-8.18%	1,447,563	84,508,692	54.09%	48.46%
HEALTH	29,237,054	30,555,190	15,277,595	10,715,351	$4,562,244	29.86%	1,281,973	18,557,866	35.07%	34.41%
POLICE	424,908,402	429,326,350	214,663,175	209,778,333	$4,884,842	2.28%	2,297,969	217,250,048	48.86%	46.13%
PUBLIC LIGHTING	64,827,195	68,895,949	34,447,974	34,247,377	$200,598	0.58%	15,202,567	19,446,005	49.71%	47.37%
RECREATION	28,751,182	33,611,547	16,805,773	11,082,628	$5,723,145	34.05%	4,027,285	18,501,634	32.97%	28.83%
	$787,967,501	$811,352,873	$405,676,436	$391,126,730	$14,549,706	3.59%	29,868,780	390,357,362	48.21%	45.84%